TENNESSEE GENERAL ASSEMBLY
FISCAL REVIEW COMMITTEE

FISCAL NOTE

SB 2978 – HB 3934

March 4, 2010

SUMMARY OF BILL: Establishes a graduated income tax with six rate brackets ranging from 3.5 percent to 7.75 percent; reduces the Hall Income Tax (HIT) rate from six percent to three percent for tax year 2011 and eliminates the HIT beginning with tax year 2012; holds local government harmless from loss of HIT revenue in the first year and phases out local government distribution over subsequent years; reduces the state sales tax rate from seven percent to five percent; exempts food and food ingredients from state and local sales tax; eliminates the local option sales tax; makes multiple changes to apportionment of state sales tax revenue.

ESTIMATED FISCAL IMPACT:

Increase State Revenue – Net Impact –
$611,025,000/FY10-11/General Fund
$1,165,667,000/FY11-12/General Fund
$1,170,780,500/FY12-13 and Subsequent Years/General Fund

Decrease State Revenue –
$10,550,000/FY10-11/Department of Revenue
$21,500,000/FY11-12/Department of Revenue
$22,000,000/FY12-13 and Subsequent Years/Department of Revenue

Increase State Expenditures –
$15,444,900/FY10-11/General Fund
$39,027,200 per year/FY11-12 through FY13-14/General Fund
$19,729,000/FY14-15 and Subsequent Years/General Fund

Decrease Local Revenue – Net Impact –
$979,000,000/FY10-11
$2,036,000,000/FY11-12
$2,120,000,000/FY12-13 and Subsequent Years

Assumptions:

- Based on information provided by the Department of Revenue (DOR), major computer and programming system changes will be required throughout the Department to implement the provisions of this bill. The initial one-time increase to state expenditures in FY10-11 for the beginning stages of such modifications is estimated to be $3,719,400. Additional recurring state expenditures are anticipated for subsequent modifications over the next several years as certain taxes and apportionments are changed and/or phased out. It is anticipated that such expenditures would be required for a period of three years until the new tax system has been firmly established. Such increase to recurring state expenditures is estimated to be $19,298,200 per year beginning in FY11-12 and ending with FY13-14.
- According to DOR, the department would need considerable additional resources for implementing the provisions of this bill. The Department indicates that 353 additional positions will be required (119 in Taxpayer Verification Services; 28 in the Audit Division; 54 in the Revenue Enforcement Division; 4 in the Special Investigations Division; 3 in the Legal Division; 47 in Information Technology Resources; and 98 in the Processing Division). The associated increase to recurring state expenditures is estimated to be $19,729,000 ($11,837,400 salaries, $5,918,700 benefits; $1,972,900 other). The associated one-time increase to state expenditures is estimated to be $1,861,000 (computers, software, communications, supplies, equipment, etc.).
- Based on information provided by DOR, the following are estimates for FY10-11: Decrease to state sales tax revenue of $1,778,000,000 (for general items); decrease to state sales tax revenue of $519,700,000 (for food items); decrease to state sales tax revenue of $43,000,000 (from eliminating single article tax); decrease to state sales tax revenue of $5,900,000 (from reduction of tax for telecommunications businesses); decrease to state revenue of $2,150,000 (from apportionment changes of sales tax revenue to premier type tourist resorts); decrease to state revenue of $430,000,000 (real property provisions related to franchise tax); and a decrease of state revenue of $100,000,000 (from reducing current Hall Income tax). The increase to state revenue (from the new proposed state income tax) is estimated to be $4,100,800,000 in FY10-11. The net increase to state revenue for FY10-11 is estimated to be $1,222,050,000. This estimate assumes a July 1, 2010 effective date. Due to January 1, 2011 effective date, the net increase to state revenue for FY10-11 is estimated to be 50 percent of the full-year estimate (or $611,025,000).
- There will be a net decrease to local government revenue of approximately $1,958,000,000 in FY10-11 as a result of not holding local governments harmless from the loss of state-shared sales tax revenue and local option sales tax revenue. Local governments are held harmless from the loss of apportionment of Hall Income Tax (HIT) revenue during FY10-11 only. This estimate is net of funds allocated to locals for holding them harmless from the loss of HIT revenue. The estimate assumes a July 1, 2010 effective date. Due to January 1, 2011 effective date, the decrease to local government revenue for FY10-11 is estimated to be 50 percent of the full-year estimate (or $979,000,000).
- Based on information provided by DOR, the following are estimates for FY11-12: Decrease to state sales tax revenue of $1,813,560,000 (for general items); decrease to

state sales tax revenue of $530,100,000 (for food items); decrease to state sales tax revenue of $43,860,000 (from eliminating single article tax); decrease to state sales tax revenue of $6,020,000 (from reduction of tax for telecommunications businesses); decrease to state revenue of $2,193,000 (from apportionment changes of sales tax revenue to premier type tourist resorts); decrease to state revenue of $438,600,000 (real property provisions related to franchise tax); and a decrease of state revenue of $200,000,000 (from eliminating current Hall Income tax). The increase to state revenue (from the new proposed state income tax) is estimated to be $4,200,000,000 in FY11-12. The net increase to state revenue for FY11-12 is estimated to be $1,165,667,000.

- There will be a decrease to local government revenue of approximately $2,036,000,000 in FY11-12 as a result of not holding local governments harmless from the loss of state-shared sales tax revenue, local option sales tax revenue, and the local's current share of Hall Income Tax revenue.
- Based on information provided by DOR, the following are estimates for FY12-13 and subsequent years: Decrease to state sales tax revenue of $1,849,831,000 (for general items); decrease to state sales tax revenue of $540,702,000 (for food items); decrease to state sales tax revenue of $44,737,200 (from eliminating single article tax); decrease to state sales tax revenue of $6,140,400 (from reduction of tax for telecommunications businesses); decrease to state revenue of $2,236,900 (from apportionment changes of sales tax revenue to premier type tourist resorts); decrease to state revenue of $447,372,000 (real property provisions related to franchise tax); and a decrease of state revenue of $204,000,000 (from eliminating current Hall Income tax). The increase to state revenue (from the new proposed state income tax) is estimated to be $4,265,800,000 in FY12-13 and subsequent years. The net increase to state revenue for FY12-13 and subsequent years is estimated to be $1,170,780,500.
- There will be a decrease to local government revenue of approximately $2,120,000,000 in FY12-13 and subsequent years as a result of not holding local governments harmless from the loss of state-shared sales tax revenue, local option sales tax revenue, and the local's current share of Hall Income Tax revenue.
- According to DOR, the Department will lose fee revenue for the collection of local option sales tax for local governments. Eliminating the local option sales tax will reduce DOR fee revenue by approximately $21,100,000 in FY10-11; by $21,500,000 in FY11-12; and by an amount exceeding $22,000,000 in FY12-13 and subsequent years.
- The fiscal impact for FY10-11 is estimated at 50 percent of the first full-year impact due to the January 1, 2011 effective date.

CERTIFICATION:

The information contained herein is true and correct to the best of my knowledge.

James W. White, Executive Director

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